Using Credit Wisely

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Ontario

Ministry of
Consumer and
Commercial
Relations

Buying on credit is so widespread that most of us can't imagine a world without it. We obtain goods, services and money in exchange for the promise to pay in the future.

Credit is an important financial tool that makes living more convenient and, skilfully used, it enriches life by helping us purchase goods and services as we need them. Credit used carelessly or abused causes serious problems.

Buying credit is no different from buying consumer goods. The shopper has to know when, what, where, and how much to buy, depending on needs, values, goals and income. It is vital to know both the advantages and disadvantages of credit, the cost, sources and the responsibilities involved.

The advantages of Credit

Credit makes it possible to acquire goods and services as they are needed and to pay for them with future income.

Credit gives us the use of durable goods: home, car, appliances, etc., without a long-waiting-and-saving period — during which time retail costs may rise.

Credit helps handle temporary and unexpected financial emergencies which may occur, for example, when the roof or furnace need immediate replacement.

Credit is a convenient way to buy goods and services without carrying large sums of money. There's the additional bonus of receiving a record of the charges which simplifies budgeting.

Credit allows the consideration of better quality goods than could be purchased by cash from income and it saves the depletion of savings or liquidation of investments which may earn higher rates of interest than the lender charges.

Credit enables the shopper to take advantage of sales and price reductions.

Credit purchase of durables such as a car, typewriter or laundry appliances can be employment aids and valuable time-savers.

The disadvantages of Credit

The availability of **credit** encourages the upping of living standards and repayments may take too big a slice of current income. If repayments are not carefully budgeted future income will be strained and necessities such as food, rent and clothing will have to be cut back.

The cost of **credit** will inflate the overall price of goods and services.

The ease with which a **credit** card can be used encourages impulse shopping.

The use of **credit** makes future income less flexible, therefore, it is important to consider whether the goods and services have lasting value.

Credit is a service for which we pay and goods paid for over a period of time are more costly than cash purchases. A decision must be made whether current use outweighs future costs.

Credit may require collateral and default of payment can result in the loss of valuables.

The habitual use of revolving **credit** accounts locks the shopper into one store and eliminates comparison shopping.

Credit costs money

Credit rates vary according to the source and the type of transaction. The interest charged depends on the degree of risk involved, the cost of money at a particular time plus the expenses of collection and record-keeping. The lending of money is subject to varying degrees of government regulations. One of the most important consumer protection laws is the Ontario Consumer Protection Act, 1967, which obliges everyone selling on credit to provide the borrower, before credit is given, with a clearly written statement showing the cost of borrowing both in terms of dollars and as an annual percentage rate. The lender must also show, in writing, the additional charges he intends to make if the borrower defaults on payments. This detailing of costs applies not only to contracts for goods purchased on credit, but to overdue monthly charge accounts and to all loans.

Credit worthiness

To get credit, whether it be a personal loan, a charge account or a credit card, depends on your credit rating based on what those making loans call the four C's: character, capacity, capital and commonsense.

Character means a sincere attitude towards the paying of bills based on previous financial record.

Capacity includes employment record and the ability to pay instalments on current income.

Capital is what is owned that is worth more than the debt, for example, financial resources such as life insurance, savings, car, equity in a home, household goods.

Commonsense is the ability to use credit wisely, to be honest in disclosure of income and other debts.

Credit worthiness is determined by personal interview after an initial written application.

Credit Bureaus

With the growth of credit, retailers and lending agencies verify the information given at the interview through a **Credit Bureau**, which collects information from a variety of sources. Ratings begin the first time you use credit and records are maintained; however, you can discuss your ratings with your local bureau. A consumer credit rating is a valuable commodity; protect it by using credit wisely.

The sources of Credit

There are a number of ways of obtaining credit:

Banks: offer a variety of consumer credit plans with interest rates varying with the type of loan, the borrower's credit reputation and collateral security.

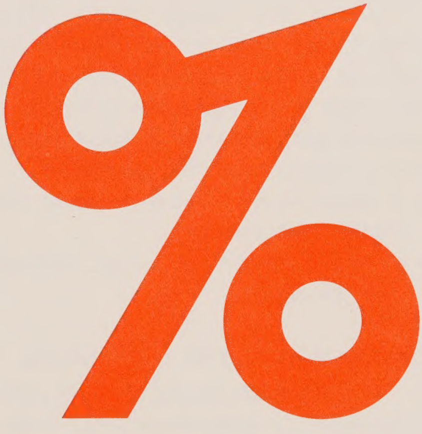
Credit Unions: are co-operative institutions that have two basic functions: accepting savings and extending loans to members.

Trust Companies: extend personal loans and are an important source of mortgage money.

Consumer Loan Companies: are private businesses. Loans under $1,500 have the interest regulated by the Canadian Small Loans Act. Interest on loans over this amount are set by the companies themselves.

Note: This is a 'Beware' area: if a borrower is over-extended and has a number of outstanding debts there is often desire and pressure to consolidate and make one payment a month. Often this refinancing brings the borrower out of the Small Loans Act protection, and into higher interest.

Sales Finance Companies: buy instalment purchase contracts from retailers who don't want to tie up working capital for long periods while the consumer pays for a car, etc. Few consumers realize that, in addition to a sales contract, they are also signing a promissory note which will be sold to the sales finance company which will receive the monthly payments. Under the Bills of Exchange Act, merchants have to mark promissory notes "Consumer Purchase" and the finance company is held responsible for product quality and service should the merchant default.



Life Insurance Companies: will lend money on the cash value of a life policy; the interest rate is low in comparison with other lenders but this is understandable. You are, in effect, borrowing your own money! The loan is secured by the cash value of the policy and the outstanding amount is deducted should death occur.

Credit Card Organizations: issue identification cards which recognize that the customer's credit will be honoured by the issuer up to a predetermined amount. Accounts paid within thirty days of receipt are interest-free, overdue accounts are charged at a pre-disclosed rate of interest.

Retail Credit: store charge accounts are interest-free for thirty days; overdue accounts are charged interest on the outstanding balance. Long term retail store "revolving", "budget", and "homeowner" accounts are in reality high interest loans.

When you want credit, shop around: not only are there different types of lending agencies but, within their own groupings, rates vary. Compare the rates and terms offered to you, then evaluate your own situation.

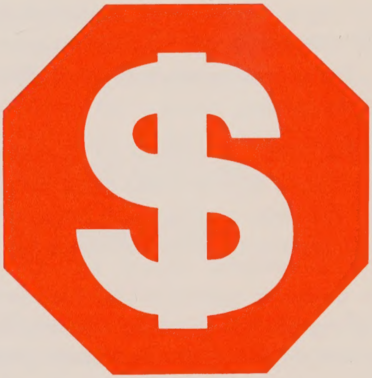
- A large down payment makes for smaller instalments.
- A quick repayment keeps interest charges down.

Coping with Credit Difficulties

Credit troubles come through over-extension, mismanagement, inexperience or unforeseen emergencies. A debtor who wants to pay, but can't, keeps a good credit rating and avoids unpleasantness by going to the creditor with the problem before payment is due.

When payments are not met, the merchandise as well as the money paid can be lost through repossession. However, if more than two-thirds of the debt has been paid, repossession cannot take place without a court order under the Ontario Contract Instalment Act.

Don't sign a contract until you have read it and understood it. If you don't understand, ask questions until satisfied. Never sign a blank sheet. Your signature is your promise to pay and a contract is a legal document.



For further information, contact:

Consumer Protection Bureau,
Ministry of Consumer and
Commercial Relations,
555 Yonge Street,
Toronto, Ontario.

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